

(2) Any business development corporation, which for purposes of this section, means a corporation which was created by or pursuant to an act of a State legislature for purposes of promoting, maintaining, and assisting the economy and industry within such State on a regional or statewide basis by making loans which would generally not be made by banks (as defined in section 581 and the regulations thereunder) within such region or State in the ordinary course of their businesses (except on the basis of a partial participation), and which is operated primarily for such purposes.

[T.D. 7444, 41 FR 53482, Dec. 7, 1976]

§ 1.586-2 Addition to reserve.

(a) *General rule.* Except as provided by paragraph (b) of this section, the amount computed under this section is the amount necessary to increase the balance of the reserve for bad debts (as of the close of the taxable year) to the greater of:

(1) The amount which bears the same ratio to loans outstanding at the close of the taxable year as (i) the total bad debts sustained during the taxable year and the 5 preceding taxable years (or, with the approval of the Commissioner, a shorter period), adjusted for recoveries of bad debts during such period, bears to (ii) the sum of the loans outstanding at the close of such 6 or fewer taxable years, or

(2) The lower of:

(i) The balance of the reserve as of the close of the base year, or

(ii) If the amount of loans outstanding at the close of the taxable year is less than the amount of loans outstanding at the close of the base year, the amount which bears the same ratio to loans outstanding at the close of the taxable year as the balance of the reserve as of the close of the base year bears to the amount of loans outstanding at the close of the base year. For purposes of subparagraph (2) of this paragraph, the term *base year* means the last taxable year beginning on or before July 11, 1969. For purposes of applying this paragraph, a period shorter than the 6 years generally would be appropriate only where there is a change in the type of a substantial portion of

the loans outstanding such that the risk of loss is substantially increased. For example, if the major portion of a business development corporation's portfolio of loans changes from agricultural loans to industrial loans which results in a substantial increase in the risk of loss, a period shorter than the 6 years may be appropriate. If approval is granted to use a shorter period, the experience for those taxable years which are excluded shall not be used for any subsequent year. A request for approval to exclude the experience of a prior taxable year shall not be considered unless it is sent to the Commissioner at least 30 days before the close of the current taxable year. The request shall include a statement of the reasons such experience should be excluded.

(b) *New financial institutions*—(1) *Small business investment companies.* In the case of a new financial institution which is a small business investment company to which section 586 applies, the amount computed under this section is the greater of the amount computed under paragraph (a) of this section or the amount necessary to increase the balance of the reserve for bad debts as of the close of the taxable year to the amount which bears the same ratio to loans outstanding at the close of the taxable year as:

(i) The total bad debts (as determined by the Commissioner) sustained by all such small business investment companies during the 12-month period ending on March 31 that ends with or within the taxpayer's previous taxable year, and during the five 12-month periods ending on March 31 that precede such 12-month period, adjusted for recoveries of bad debts during such periods (as determined by the Commissioner), bears to

(ii) The sum of the loans outstanding (as determined by the Commissioner) by all such small business investment companies at the close of each of such six 12-month periods ending on March 31.

(2) *Business development corporations.* In the case of a new financial institution which is a business development corporation to which section 586 applies, the amount computed under this section is the greater of the amount

computed under paragraph (a) of this section or the amount necessary to increase the balance of the reserve for bad debts as of the close of the taxable year to the amount which bears the same ratio to loans outstanding at the close of the taxable year as:

(i) The total bad debts (as determined by the Commissioner) sustained by all such business development corporations during the calendar year ending with or within the taxpayer's previous taxable year and during the 5 calendar years preceding such calendar year, adjusted for recoveries of bad debts during such period (as determined by the Commissioner), bears to

(ii) The sum of the loans outstanding (as determined by the Commissioner) by all such business development corporations at the close of each of such 6 calendar years.

(c) *Definitions.* For purposes of this section:

(1) *New financial institution.* A financial institution is a new financial institution for any taxable year beginning less than 10 years after the day on which it (or any predecessor) was authorized to do business as a financial institution described in the applicable subparagraph of § 1.586-1(b). For this purpose, the term *predecessor* means (i) any taxpayer which transferred more than 50 percent of the total amount of its assets to the taxpayer and is described in the same subparagraph of § 1.586-1(b) which describes the taxpayer, or (ii) any predecessor of such predecessor.

(2) *Loan.* (i) The term *loan* means debt, as the term *debt* is used in section 166 and the regulations there-under.

(ii) The term *loan* does not include the following items:

(A) Discount or interest receivable reflected in the face amount of an outstanding loan, which discount or interest has not been included in gross income;

(B) A debt evidenced by a security (as defined in section 165(g)(2)(C) and the regulations thereunder); and

(C) Any loan which is entered into or acquired for the primary purpose of enlarging the otherwise available bad debt deduction.

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MUTUAL SAVINGS BANKS, ETC.

§ 1.591-1 Deduction for dividends paid on deposits.

(a) *In general.* (1) In the case of a taxpayer described in paragraph (c)(1) or (2) of this section, whichever is applicable, there are allowed as deductions from gross income amounts which during the taxable year are paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw.

(2) The deduction provided in section 591 is applicable to the taxable year in which amounts credited as dividends or interest become withdrawable by the depositor or holder of an account subject only to customary notice of intention to withdraw. Thus, amounts which, as of the last day of the taxable year, are credited as dividends or interest, but which are not withdrawable by depositors or holders of accounts until the following business day, are deductible under section 591 in the year subsequent to the taxable year in which they were so credited. A deduction under this section will not be denied by reason of the fact that the amounts credited as dividends or interest, otherwise deductible under section 591, are subject to the terms of a pledge agreement between the taxpayer and the depositor or holder of an account. In the case of a domestic building and loan association having nonwithdrawable capital stock represented by shares, no deduction is allowable under this section for amounts paid or credited as dividends on such shares. In the case of a taxable year ending after December 31, 1962, for special rules governing the treatment of dividends or interest paid or credited for periods representing more than 12 months, see section 461(e).

(b) *Serial associations, bonus plans, etc.* If a taxpayer described in paragraph (c)(1) or (2) of this section, whichever is applicable, operates in whole or in part as a serial association, maintains a bonus plan, or issues shares, or accepts deposits, subject to fines, penalties,